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Managing Director & Principal***

August 1, 2011

Dr. George Diehr
Chair of the Investment Committee
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Revision of Interim Asset Allocation Targets

Dear Dr. Diehr:

You requested Wilshire's opinion with respect to the proposed revisions to Interim Asset Allocation Targets proposed by Staff. Wilshire recommends adoption of the revised targets as presented by Staff.

Recommendation

Wilshire recommends adoption of the revised targets as presented by Staff.

Background

After the 2010 Asset Allocation Workshop, the Investment Committee approved a new target allocation. In May, Staff proposed interim targets to gradually shift the fund from its current allocation to the new target. Included at that time was a 10% allocation to Real Estate across all time periods – 10% was both the prior target and the new target, so keeping the target level seemed logical.

However, Real Estate's actual allocation is less than 8%, or approximately \$5 billion from its long term target. Given the market demand for real estate, deploying an additional \$5 billion in net exposure (likely ~\$10 billion in gross exposure) at fair prices will take a considerable amount of time. Thus, the underweight will persist for some meaningful amount of time, especially since Staff has been focusing more over the past few years on disposing of problem assets and improving the quality of the existing portfolio than on making new investments.

After further discussion with Staff regarding the underweight to Real Estate and a variety of solutions that could be used to reduce the magnitude of it, it has become apparent that this underweight causes two problems. First, the underweight to Real



Estate without adoption of these revised interim targets would cause tracking error between the total fund and the total fund benchmark. Wilshire estimates this tracking error to be roughly 0.3%, which is non-trivial. Second, the underweight to real estate will cause other asset classes to be overweight. The revised targets simply provide guidance as to the investment of those overweights and the timing of any changes as the Real Estate target and portfolio increase.

Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,